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National City Monthly Letter on Business and Economic Conditions

New York, August, 1954

General Business Conditions

THE summer lull has taken its usual toll of industrial production. In recent years the custom of shutting down plants partly or completely sometime during July, for vacations required by union contracts, for maintenance and repair work, or for inventory taking, has spread more and more widely. Even where plantwide vacations are not the rule, as in steel mills, shipments are curtailed when customers close down.

In some cases manufacturers are reported extending their shutdowns this year, as a convenient way of working off finished goods inventories. Cutbacks in the petroleum industry, in both refinery operations and crude production, and continued curtailment in steel, likewise suggest that the seasonal decline may be a little greater than usual. If this proves to be the fact, however, it will have little significance. It is always difficult to tell whether factory closings are more or less than "normal", and even the indexes supposedly "adjusted for seasonal variation" have a hard time keeping up with changing vacation habits. For that reason the gyrations of production indexes in July are not a reliable guide to the trend.

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Current comment on the industrial and trade news shows that business men see little other than seasonal dullness in the picture, and that confidence in moderate autumn improvement is fairly general. The slackness in steel is in part a reaction to overbuying in May and June, when customers hedged against a strike or price rise, and the industry expects demand to increase within a month or two. Automobile production has slowed, despite heavy sales in June, because dealers need time to work off stocks. Curtailment for model changes will come later in the summer. Autumn expansion, however, will follow.

Defense Business Picking Up

In both consumer and defense goods lines business appears to be picking up. New orders for aircraft, tanks and combat vehicles are ending the long drought in defense contracts, and in due course will halt the drop in production of military goods. New shipbuilding contracts are in sight. Construction, both residential and nonresidential, is maintaining its breath-taking pace. Overall measures of activity such as national income or gross product appear to be firming somewhat.

In the broad sense, business has been stable for five months. In both production and prices the ups and downs of products in different stages of adjustment have roughly offset each other. For the most part, movements in either direction have been moderate. The prospect is that they will continue that way. Business has withstood a drop in buying, production and employment without going into a downward spiral. The strength of the influences supporting consumer purchasing power, encouraging construction and investment, and so stemming the decline, has

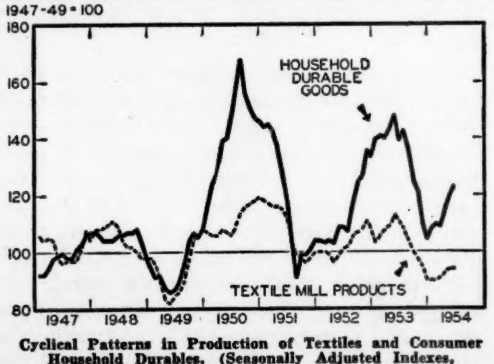
been demonstrated. On the other hand, there is little in sight to bring about a sharp advance.

Consumers Spending More Freely

Credit for halting the downturn and fostering revival lies to a great extent with the American consumer. Total consumer spending on goods and services in the second quarter of this year was at the highest rate ever reached in this country, according to preliminary reports. The rise in outlays for services is one of the most persistent economic trends of recent years; they have increased steadily – virtually without interruption – for over 20 years and have more than quadrupled in that time. Rising rents have helped push the total higher in the postwar period, but their influence is waning; the Bureau of Labor Statistics reports that June was the first month since World War II in which the average level of rents failed to rise. Transportation, travel, medical care, amusements, and many other types of services have also shared in the steady advance.

This Letter last month noted better retail sales in June, and official figures show that the seasonally adjusted index for the month was 2 per cent better than in May and within 1 per cent of June last year. Sales of new passenger cars reached the highest monthly total in nearly four years. July is unlikely to show as well in automobile sales, but in general merchandise – allowing for the usual dent made by hot weather – it apparently has been a good month.

Consumers have received approximately the same high level of disposable income throughout the past year, but in the second quarter of 1954 they began to spend more and save less. They even went somewhat more freely into debt to buy what they wanted, instead of paying off debts on balance as they did in the first quarter. Most people now realize that there is little reason



Cyclical Patterns in Production of Textiles and Consumer Household Durables. (Seasonally Adjusted Indexes, 1947-49 = 100)

to postpone buying in expectation that prices will fall. They have noted unemployment levelling off and the work week lengthening, and fear of layoffs has diminished. Retailers have stepped up promotion and selling efforts, while manufacturers are working hard to bring to the markets better products and new models.

Output of consumer goods seems definitely on the upgrade. The accompanying chart shows (in terms of Federal Reserve Board seasonally adjusted indexes) the postwar production experience of two groups of products – consumer household durable goods and textile mill products – which have been notorious for their periodic ups and downs.

Output of both industries dropped sharply in the latter half of 1953 and started back up during the first half of this year. The recovery in household durables, which include appliances, furniture, and radio and television sets, has been the more marked of the two. In this series, the rise of 17 per cent in six months has been nearly as rapid as the snap-back from the low point of the 1949 recession, and faster than in 1951, when restrictions on the use of metals speeded the cutback in production and hampered the subsequent recovery.

The upturn in textiles has been sluggish so far and less pronounced than after previous postwar inventory adjustments. With allowance for the season, however, textile mill operations are better than at the turn of the year, and prospects for the fall indicate a pickup, although profit margins may be slim. In these industries, as in many others, the period is one of consolidation, reorganization, and adjustment to highly competitive markets. The fact that the adjustment is taking place in almost all sections of the economy in orderly fashion, with overall business at a high level and confidence sustained, is evidence of the power of stabilizing influences, financial strength, and skilled management.

Half Year Corporate Earnings

Corporate reports for the first half year show that sales and earnings generally have continued at relatively high levels despite a moderate recession in overall activity from its all-time peak. The showing is extremely mixed, however, both among different industries and among individual companies in the same industry as a result of highly uneven changes in production, shipments, operating expenses, and federal taxes.

Our tabulation of earnings reports issued to date by 660 corporations gives combined net income after taxes of $3,688 million, an increase of 2 per cent over the first half of last year.

NET INCOME OF LEADING CORPORATIONS FOR THE SECOND QUARTER AND FIRST HALF YEAR

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income Second Quarter 1953	Reported Net Income Second Quarter 1954	Per Cent Change	Reported Net Income Half Year 1953	Reported Net Income Half Year 1954	Per Cent Change
25	Food products	$ 28,105	$ 36,341	+ 29	$ 61,034	$ 72,266	+ 18
14	Beverages	11,650	10,752	— 8	21,445	17,892	— 17
12	Tobacco products	33,123	34,362	+ 4	58,853	64,700	+ 10
22	Textiles and apparel	14,851	3,347	— 77	31,922	11,349	— 64
20	Paper and allied products	22,102	27,198	+ 23	43,404	53,202	+ 23
32	Chemical products	146,532	161,123	+ 10	286,917	311,790	+ 9
14	Drugs, soap, cosmetics	14,987	17,964	+ 20	35,810	38,130	+ 6
26	Petroleum producing and refining	418,773	425,444	+ 2	812,489	874,724	+ 8
30	Cement, glass, and stone	48,128	50,515	+ 5	86,192	85,656	— 1
32	Iron and steel	166,034	142,221	— 14	314,761	265,155	— 16
13	Building, heating, plumbing equipment	13,010	14,775	+ 14	23,914	27,120	+ 13
18	Electrical equipment, radio and television	78,391	81,530	+ 4	149,486	174,544	+ 17
41	Machinery	33,927	39,679	+ 17	66,030	75,763	+ 15
8	Office equipment	16,131	19,419	+ 20	30,816	37,806	+ 23
7	Automobiles and trucks	163,112	237,403	+ 46	315,793	427,639	+ 35
25	Automobile parts	26,411	24,944	— 6	51,578	44,263	— 14
9	Railway equipment	12,014	7,606	— 37	23,248	16,535	— 29
72	Miscellaneous metal products	102,036	110,017	+ 8	195,812	196,417	+—
37	Miscellaneous manufacturing	32,828	36,414	+ 11	62,778	69,897	+ 11
457	Total manufacturing	1,382,140	1,481,049	+ 7	2,672,282	2,864,848	+ 7
26	Mining and quarrying	26,176	26,413	+ 1	48,562	48,981	+ 1
20	Trade (retail and wholesale)	15,473	14,973	— 3	27,802	27,860	+—
17	Service and amusement industries	10,606	9,620	— 9	25,735	19,739	— 23
45	Railroads	195,692	114,657	— 41	365,009	201,493	— 45
57	Electric power, gas, etc.	104,142	111,313	+ 7	238,802	256,137	+ 7
38	Telephone and telegraph	126,957	136,223	+ 7	247,370	269,228	+ 9
660	Total	$1,861,186	$1,894,248	+ 2	$3,625,562	$3,688,286	+ 2

About 52 per cent of the reporting companies had increases, against 48 per cent with decreases.

For the second quarter alone, net income of $1,894 million was up 6 per cent from the preceding quarter and 2 per cent from the second quarter a year ago. The number having decreases as compared with the second quarter last year exceeded slightly the number with increases.

The above table gives a condensed summary of the changes by major industry groups.

Changes in Manufacturing

Figures for 457 manufacturing companies, which in numbers and in dollar earnings account for over half the total of all companies in the tabulation, show net income for the half year up 7 per cent. Groups having increases include food, paper, chemicals, petroleum, electrical equipment, building equipment, and machinery, while those with decreases include beverages, textiles, steel, and railway equipment. Every group contained important companies whose results ran counter to the general trend.

Decreases in dollar sales billed were reported by two out of three manufacturing companies; the combined total of sales was down about 7 per cent. Operating expenses were reduced, but two out of three companies had a decrease in pre-tax earnings, which for the group were down 18 per cent. The latter decreases, however, were in most cases more than offset by the drop in the provision for federal income taxes payable, reflecting in part the expiration of the excess profits tax last December 31. Such tax reserves in dollars declined 35 per cent. They absorbed about 49 per cent of pre-tax income, compared with 61 per cent in the first half of last year.

Sales and Net Income of 457 Manufacturing Corporations in the First Half Year

(In Millions of Dollars)

	1953	1954	Change Amount	Change %
Receipts from sales, etc.	$44,210	$41,220	—2,990	— 7
Total costs, except taxes	37,321	35,596	—1,725	— 5
Balance before taxes	6,889	5,624	—1,265	—18
Federal income & e. p. taxes	4,217	2,759	—1,458	—35
Net income after taxes	2,672	2,865	+ 193	+ 7
Taxes to balance before taxes	61%	49%		
Net income per sales dollar	6.0c	7.0c		

Technically, the combined rate of corporate normal tax and surtax this year was 52 per cent for the first quarter only, by law declining to 47 per cent on April 1. In view of the provision in the Internal Revenue Revision bill just passed extending the 52 per cent rate retroactively, however, corporations generally have continued to use that rate in preparing financial statements this year. In practical application, of course, the average effective rate, particularly in the case of a group of companies, always differs somewhat from the basic rate because of special types of income credits, allowable deductions, etc.

In a number of lines where the drop in pre-tax earnings was much sharper than average, the decline in taxes served as only a partial offset.

An example is the steel industry, which operated at an average rate of about 70 per cent of capacity as against virtually 100 per cent in the first half of '53. Reports available from 32 steel producers show that dollar sales decreased by 18 per cent and, despite strict curtailment of operating expenses, the pre-tax earnings dropped by 36 per cent. Although federal taxes payable were 49 per cent lower, the remaining net income was cut 16 per cent.

The fact that federal taxes still take more than half of the income balance means that they tend to offset considerably any changes, up or down, in operating earnings and thus to stabilize the remaining net income. Moreover, in recent years the fluctuations among different industries have tended to offset one another materially and thereby also to have a stabilizing effect on the net earnings of manufacturing considered as a whole. This may be seen from the following summary of quarterly totals for the companies in our tabulation:

Quarterly Net Income After Taxes of 457 Manufacturing Corporations

(In Millions of Dollars)

	1952	1953	1954
First quarter	$1,183	$1,290	$1,384
Second quarter	1,106	1,382	1,481
Third quarter	1,135	1,372	
Fourth quarter	1,489	1,484	

In lines other than manufacturing, increases in half year net income are shown by the group totals in our table for electric, gas, and telephone utilities, decreases for railroads, services and amusements, and little change for mining and trade.

Treasury Financing

As an initial major step to meet July-December cash requirements estimated at $10 billion, the Treasury opened subscription books July 21 on an offering of $3½ billion Tax Anticipation Certificates of Indebtedness to cover outlays through September. Dated August 2 and paying a rate of 1 per cent, the new certificates are usable, at par and with interest to their maturity March 22, in payment of March 15 income and excess profits taxes.

The 1 per cent rate, contrasting with 2½ per cent paid on similar obligations a year ago, illustrates how much the market has changed in the meantime. Nevertheless, the 1 per cent rate exceeded expectations. Although the books were open only one day, total subscriptions exceeded $9¼ billion, necessitating a 40 per cent allotment basis beyond the first $50,000 which was allotted in full. Payments are due August 2.

With the cash financing out of the way the Treasury turned to refunding $2.8 billion 2⅝ per cent certificates due August 15 and $4.7 billion 2⅝s due September 15. On July 30 rates and maturities for the exchange securities were announced: one-year 1⅛ per cent certificates due August 15, 1955 or six-year three-months 2⅛ per cent bonds due November 15, 1960. Both issues will be dated August 15. Exchange subscription books will be open for three days, August 3-5. A high exchange percentage is expected.

The present instance is the sixth time in the past year and a half in which the Treasury has offered holders of maturing obligations a choice of exchange securities in an effort to extend debt maturities. The five previous optional exchange offerings shifted $19.4 billion maturing securities (55 per cent of the total publicly held) into longer issues ranging from three and one half to seven and three quarter years in maturity.

Shifts in Debt Structure

The Treasury has avoided long-term bond offerings since May, 1953 when $1.6 billion thirty-year bonds were issued, and has done the bulk of its new-money borrowing in the short-term area, mostly by tax anticipation types of obligations. This has led some critics to assert that the Treasury has repudiated its pledge to cut down the short-term floating debt as a contribution to economic and monetary stability. Going back to December 31, 1951, before the Truman Administration put out the first postwar marketable bond issues, the proportion of the marketable public debt due within one year has increased from 34 per cent to 41 per cent. The proportion maturing after ten years has fallen from 29 to 21 per cent.

On the other hand, as the following table shows, there has been a marked shift out of the one-to-five year category and into the five-to-ten year block. This shift is mainly a product of the conversion offer of 2½ per cent bonds of 1961 last February. A good response to the Treasury offering of six-year three-months 2⅛s in exchange for the $7½ billion maturing August and September 2⅝s would fatten up the five-to-ten year block even more and cut down the proportion due within one year somewhat.

This is a real, though admittedly limited, accomplishment. The record shows, as Undersecretary of the Treasury W. Randolph Burgess

Structure of the Marketable Public Debt* for Selected Dates

(Dollar figures in billions)

	Dec. 31, 1941	Dec. 31, 1945	Dec. 31, 1951	Aug. 2, 1954
Due within 1 year	$ 8.0	$ 68.6	$ 48.2	$ 63.9
Due in 1-5 years	8.5	20.5	44.4	27.9
Due in 5-10 years	7.6	46.6	8.9	30.5
Due after 10 years	22.5	63.1	41.2	31.7
Total	$41.6	$198.8	$142.7	$154.0
Due within 1 year	7.2%	34.5%	33.8%	41.5%
Due in 1-5 years	20.4	10.3	31.1	18.1
Due in 5-10 years	18.3	23.4	6.3	19.8
Due after 10 years	54.1	31.8	28.8	20.6
Total	100.0%	100.0%	100.0%	100.0%

*Treasury bills, certificates, notes and bonds which are traded in the open market. The nonmarketable debt on June 30, 1954 included $58.1 billion Savings bonds, $5.1 billion Saving notes, $12.8 billion investment series bonds, $42.2 billion special issues to government trust funds and agencies and $2.8 billion matured and miscellaneous debt.

pointed out last fall, how fast the Treasury must run simply to hold even and offset the effect of the passage of time in shortening debt maturities. With the easing that has occurred in the mortgage and capital markets the remainder of 1954, when the Treasury will have about $6 billion more to raise to cover the rest of its seasonal deficit, may bring suitable opportunities to resume offerings of longer-term bonds and carry forward with a program which, even under the best of circumstances, is bound to take a long time.

The Boom in Home Building

Home building, after eight years of record-breaking performance, is continuing at a rate which promises to make 1954 another boom year in dwelling construction. For the first six months the total number of nonfarm dwelling units (houses and apartments) started throughout the country, as reported by the U.S. Department of Labor, came to 574,800. This was only a shade below the total for the same period a year ago, and an annual rate in excess of 1 million starts for the sixth successive year.

This showing is all the more noteworthy in view of the cutback in public housing. As indicated in the table, public housing starts have declined sharply from the 1951 peak, and in the first six months of this year totalled only 10,700, compared with 28,300 in the first half of '53. Private starts of 564,100, on the other hand, were 11,000 greater than a year ago and the largest for any similar period since record 1950.

Data collected by the F. W. Dodge Corporation on residential contract awards (work to be started) in the 37 states east of the Rockies show for the first six months of this year a 17 per cent gain in the number of family units provided, and a 22 per cent gain in dollar totals.

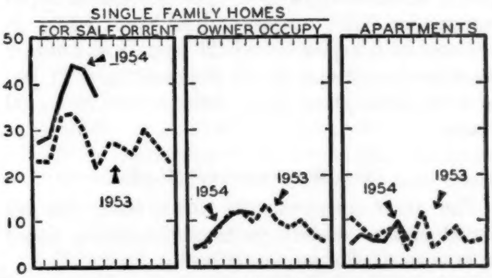
Number of New Nonfarm Housing Units Started in the U.S.

(In Thousands)

	Total	Public	Private	Seasonally adjusted annual rates: private
1949: Totals	1,025.1	36.3	988.8	—
1950: "	1,396.0	43.8	1,352.2	—
1951: "	1,091.3	71.2	1,020.1	—
1952: "	1,127.0	58.5	1,068.5	—
1953: "	1,103.8	35.5	1,068.3	—
1953: January	72.1	3.9	68.2	1,106.0
February	79.2	5.4	73.8	1,150.0
March	105.8	9.7	96.1	1,165.0
April	111.4	4.0	107.4	1,111.0
May	108.3	2.7	105.6	1,065.0
June	104.6	2.6	102.0	1,064.0
6 months	581.4	28.3	553.1	—
1954: January	66.4	1.3	65.1	1,056.0
February	75.2	1.3	73.9	1,152.0
March	95.2	2.0	93.2	1,130.0
April	111.0	1.2	109.8	1,136.0
May	107.0	0.5	106.5	1,074.0
June	120.0	4.4	115.6	1,206.0
6 months	574.8	10.7	564.1	—

Source: U.S. Department of Labor.

As to types of housing contracted for, the Dodge reports reveal that the gains have been mainly in the single family homes built for sale or rent — the "speculative" type.



Thousands of New Family Dwelling Units Provided in Monthly Contract Awards, Public and Private, in 37 Eastern States.

Influence of Easy Money

The renewed surge in private home building this year has been spurred powerfully by the change in the mortgage market over the past twelve months.

During the early part of last year this market experienced a squeeze under the influence of tighter money generally and rising interest rates for government and other high grade securities. Despite this rising trend, rates on mortgages insured by the Federal Housing Administration or guaranteed by the Veterans Administration remained pegged at 4¼ and 4 per cent respectively until May; when lifted to 4½ per cent each they were still out of line with general money rates which in the meantime had advanced further. Reflecting this lag in adjusting federal mortgage rates, lending institutions turned to the relatively attractive yields obtainable elsewhere, after allowance for mortgage servicing costs. As a result,

builders found increasing difficulty in financing their operations.

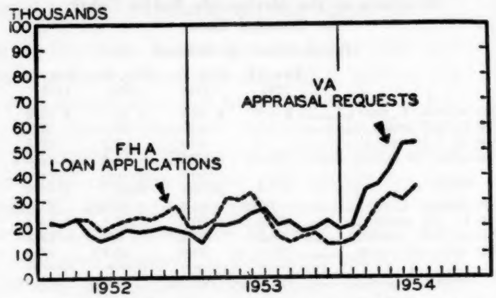
With the relaxation of Federal Reserve credit policy around the middle of '53, and the ensuing general easing of money conditions, the mortgage market began a recovery which became pronounced after the turn of the year. In Eastern markets FHA and VA 4½s, which a year ago were quoted down around 95-96, recovered to par, with some subsequent easing.

More important to the home buyer than lower interest rates has been the trend to greater liberality as to down payments and mortgage maturities. For example, whereas a year ago lenders generally were asking at least 5 per cent down payments and maximum maturities of 20-25 years, today there is an abundance of mortgage money and there have been many instances of lending institutions competing for VA guaranteed liens financing GI home purchases on the basis of nothing down and 30 years to pay. The chart in the next column shows the jump this spring in requests for VA loan appraisals, together with the more moderate increase in applications for FHA insurance. In May nearly 25 per cent of all guaranteed GI home loans closed were made without down payment, and 61 per cent of such loans were written for 25 to 30 years.

Are We Overbuilding?

The great question that arises from this renewal of our already protracted housing boom is, how much longer can it last?

The question has been asked before, and predictions of an imminent collapse have been made repeatedly only to be disproved. Current reports indicate a sustained demand for desirable housing in most communities. According to recent surveys by the National Association of Real Estate Boards and the U.S. Savings &



VA Appraisal Requests and FHA Loan Applications for Financing New Home Construction

Loan League, prices of new homes continue generally firm, though prices of existing houses show some easing tendency. Both surveys indicate a sustained demand for rental housing, with relatively few instances of oversupply.

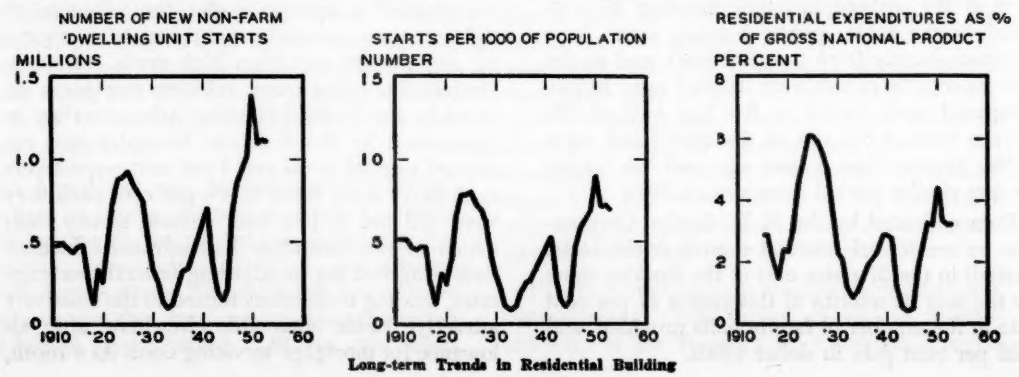
The Historical Record

One approach to the question of overbuilding is to look at the historical record. How do present levels of building compare with those in the past? The charts at the foot of the page show the long-term trends in residential building.

It will be seen that on the basis of the sheer numbers of housing starts the present building boom surpasses all others. The nearest approach was during the '20s when for several years housing starts exceeded 800,000 family units.

The chart brings out the long period of subnormal building during the depression and war years when the population was growing and a backlog of demand was accumulating. This in itself goes far to explain the current boom.

The chart on housing starts per 1000 of population gives quite another picture. Here it will be seen that when growth of population is taken into account, home building while high has not



Long-term Trends in Residential Building

been greatly out of line with levels reached during the '20s.

The chart depicting expenditures on residential construction as percentages of the gross national product tells still another story. By this measure, recent rates of spending on new housing have been well below the levels of the '20s.

Trend of Marriages and Household Formation

Still another test for overbuilding is in comparing housing starts with the number of marriages and growth in the number of households.

Some indications of the latter appear in the estimates of the Bureau of the Census based on annual samplings throughout the country. A "household", according to Census Bureau definition, includes persons who occupy a home that constitutes a dwelling unit. Changes in the number of households are affected largely by marriages, divorces, deaths, and doubling or undoubling of individual family units.

Number of Marriages, Increase in Number of Households, and Number of Married Couples Without Households

Year	Number of Marriages	Increase in Households	Married Couples Without Households
1940	1,595,879	504,400†	1,946,435
1946	2,291,045	711,000	*
1947	1,991,878	1,151,000	2,861,000
1948	1,811,155	1,582,000	2,455,000
1949	1,579,798	1,387,000	2,156,000
1950	1,667,231	1,485,000	2,016,000
1951	1,621,159	1,027,000	1,758,000
1952	1,562,579	987,000	1,558,000
1953	1,553,000	956,000	1,546,000

Figures on marriages cover calendar years, with 1953 estimated. Figures on households and on married couples without households represent estimates for April of each year. * Not available. † Average annual increase 1930-40.

The number of marriages has declined steadily (save for a temporary upturn due to the Korean war) since the peak reached in 1946 with the demobilization of World War II veterans. At that time the number of households established was limited by the acute housing shortage (reflected also in the number of married couples without households, or doubled up with relatives), but household formation rose to high levels during 1948, 1949, and 1950, as more new houses were built and as many of the large, older houses were remodelled and converted into smaller apartments.

From 1950 to 1952 the rate of increase in the number of households slowed down, but in 1952 and 1953 it was still estimated in excess of 900,000 units annually. While this was almost double the prewar average, it was below the '52 and '53 officially reported housing starts of 1,127,000 and 1,104,000 respectively.

Population experts generally have expected the decline in family formation to continue over the next few years, because of the low birth rates of the depression years and the smaller number of young people now coming into the marriage ages. This has led to bearish projections of home building until such time as the higher birth rates following the outbreak of World War II bring an upsurge in family formation and housing demand in the early '60s.

Other Influences Affecting Home Building

However, demand for housing has been sustained by a number of important influences other than marriages and family formation, and this may continue.

First, families have been having more children. Though marriages continued to decline in '52 and '53, the great American baby boom has shown no sign of slackening. Births last year reached a new high of nearly 4,000,000 and figures so far this year indicate another record total. Many of the houses built since the war have been small, two-bedroom homes, and these growing families are forced to expand them or seek larger quarters.

Second, the undoubling of family units may still have further to go. Higher incomes have made young couples independent earlier. The widespread increase of pensions in industry has also been a factor, making it possible for the "old folks" to maintain separate homes apart from their children and "in-laws". This has become an increasingly important source of new households as older people live longer.

Third, conversions of older homes, which have provided an important addition to the supply of dwelling units, are likely to be less as fewer suitable houses are left for remodeling. The filling of housing needs will, therefore, rest more heavily upon new construction in the future.

Fourth, the shifting of population from cities to suburbs and from one part of the country to another adds to the need for new housing facilities.

Fifth, the general prosperity and wider distribution of incomes have created a demand for better homes. This is reflected in the movement of people from the crowded cities to the less congested areas. Likewise, people generally are becoming less content to live in the older, obsolete houses, with their inconveniences and unsuitability to modern conditions. In short, the replacement demand for homes, which has been small historically due in part to the long life of houses, has been stepped up, and — barring a depression that would force people to retrench — it may continue at a higher level than in the past.

Finally, the further liberalization of FHA mortgage credit terms provided in the new hous-

ing legislation adopted by the Congress should give some stimulus to home buying, particularly for older houses and non-veteran purchasers.

Income the Key Factor

Evidently the home construction industry has no predetermined saturation point. Continuance of active building depends upon a complex of factors, including size as well as number of families, migration, condition of present homes, availability and terms of mortgage credit, trend of rents, what the buyer can afford based upon current income, and the success of the builder in offering homes of attractive design and sound value.

Of these various factors, the key undoubtedly is the state of general prosperity and the national income. As shown during the '30s, housing requirements are sensitive to changes in peoples' incomes and expectations. Home owners whose finances are squeezed, or threatened, are not generally out looking for better housing; they stay where they are, or seek smaller quarters or double up. Also, declining incomes tend to decrease marriages and births. Thus the contractive process becomes cumulative. Under such conditions, even the most liberal credit incentives for new construction are likely to be ineffective.

Conversely, a high level of national income and public confidence has cumulative effects in expanding housing needs and stimulating construction. Already a downward adjustment in new home starts from the peak building year 1950 has been made, and for the past several years starts have tended to stabilize around one million annually. Given a growing population and national income, and continuance of easy credit, the building industry would appear to have the basic elements for a sustained, though not necessarily record, level of activity.

In housing, as in most other lines, realists recognize that the days of scarcities, when almost anything would sell, are over. This means two things: first, that over-stimulation of building can be dangerous—increasing the risk of supplying the market with too much too fast and bringing on the slump that people are worrying about. On this score, the recent jump in requests for VA mortgage appraisals, promoted by cheap money and exceptionally easy terms, may warrant some misgiving. Second, it means that if building is to hold up, builders must provide people with the kind of houses they want, where they want them, and at prices they are willing to pay.

While the country's desire for better homes is still far from satisfied, nevertheless, the urgent demand for shelter of the early postwar years has almost completely disappeared. As a consequence, people can afford to be more choosey and the realty market, more dependent than before on general prosperity, has become more vulnerable.

The Farm Surplus Problem

Another bumper harvest is in prospect this year, despite restrictions on several major crops and severe drought early in the season in some areas, particularly the Southwest and Central Great Plains. The Department of Agriculture, in its July crop report, indicated that the harvest will be the fourth largest on record. Although recent hot and dry weather has hurt some crops, the prospect of a large crop output still remains.

While producers have complied with acreage allotments on cotton and wheat, they have ignored government recommendations on corn, growing about as many acres as in '53. In addition, farmers have put land diverted from cotton and wheat into other cash crops instead of retiring it from cultivation.

This prospective bumper harvest foreshadows aggravation of the problems facing the Federal Government in its efforts to dispose of surplus farm products which continue to pile up in its hands under the operation of the present price support law. The Commodity Credit Corporation as of May 31, 1954 had a total investment in surplus products of $6.1 billion, nearly double a year earlier. The quantity and value of commodities held in inventory and pledged for loans, shown below, indicates how widely and deeply the Government has become involved in its price support operations.

CCC Inventory and Loan Position
(All Figures in Millions)

Commodity	Unit of Measure	Inventory May 31, 1954 Quan.	Inventory May 31, 1954 Value	Loans Outstanding May 31, 1954 Quan.	Loans Outstanding May 31, 1954 Value
Wheat	Bu.	678.0	$1,715.3	205.6	$ 452.7
Corn	Bu.	410.2	670.3	393.5	621.1
Butter	Lb.	385.4	257.7	—	—
Cottonseed Oil	Lb.	951.8	169.9	—	—
Cheese	Lb.	392.3	157.9	—	—
Dried Milk	Lb.	644.5	106.2	—	—
Wool	Lb.	122.6	85.8	12.9	5.9
Cotton Linters	Lb.	631.8	60.2	—	—
Grain Sorghum	Cwt.	19.9	54.0	2.2	5.2
Field Seeds	Lb.	116.4	42.3	3.9	.6
Flaxseed	Bu.	9.5	37.0	5.4	20.2
Gum Rosin	Lb.	311.6	23.4	35.4	2.7
Cotton	Bale	.1	20.4	7.2	1,192.6
Dry Edible Beans	Cwt.	1.7	15.9	.4	2.9
Barley	Bu.	9.8	12.9	18.4	21.6
Linseed Oil	Lb.	43.1	9.2	—	—
Oats	Bu.	6.6	5.7	30.2	23.3
Cottonseed Meal	Lb.	171.7	5.3	—	—
Peanuts	Lb.	22.8	2.8	183.5	14.8
Rye	Bu.	1.6	2.4	2.9	4.0
Tung Oil	Lb.	5.8	1.6	22.3	5.8
Rice	Cwt.	0.3	1.5	1.1	5.3
Tobacco	Lb.	4.2	1.2	606.2	264.0
Other	—	—	2.2	—	6.0
Total			$3,461.1		$2,648.2
Total Investment				$6,109.3	

Price Supports Costly

Early this year, when the CCC had practically exhausted its legal borrowing authority, the Congress came to the rescue first by authorizing the Treasury Department to cancel $682 million of the CCC's indebtedness, and later by increasing the agency's borrowing authority by $1.75 billion to $8.5 billion. Even this may not be enough. Late in June, Secretary of Agriculture Ezra T. Benson in a letter to President Eisenhower stated: "The government is in the position of having to invest public funds in almost the total crop production of the greatest producing nation of the world. It must not risk being unable to carry out its commitments, however burdensome they prove to be." On June 30 the President asked the Congress for an additional $1.5 billion to support farm prices. This request, if granted, would increase the CCC's borrowing authority to $10 billion.

Because of the tremendous surpluses, storage space required to obtain price support on crops has become increasingly tight. The CCC in an attempt to alleviate the situation has arranged to store some 70 million bushels of its grain stocks in "mothball" fleets of ships. It has built its bin capacity up to 839 million bushels and has asked for bids on up to 50 million bushels additional grain storage capacity. While farmers and the commercial grain trade also have increased their storage facilities, overall requirements cannot be met without government assistance.

Among other drawbacks, storage of surplus grains and other products is expensive, running in excess of $700,000 a day for government-owned stocks alone. Since CCC acquisitions during the months ahead are expected to continue at a heavy rate, these charges will rise accordingly unless disposals are accelerated.

In an effort to make the figures more meaningful to the average person, Secretary Benson, in an address last spring, gave the following illustration:

> Let's suppose for a moment that we were to load on a single train all of the wheat which CCC today has under loan and in its inventories. Such a train would extend all of the way from San Francisco to New York and then back to St. Louis, a total of 4,222 miles . . . A train loaded with all of the wheat, corn, flaxseed, soybeans, and small grains in which CCC funds are today invested would be 8,123 miles long. It would reach one-third of the way around the world.

And still the figures did not include the surpluses of cotton, tobacco, dairy products, and other commodities.

Efforts to Sell Surpluses Domestically

The Secretary and his staff have searched unceasingly for some workable means of disposing of these surpluses. The Department of Agriculture, aided by the President's National Agricultural Advisory Commission, various commodity advisory committees, and other consultants, has studied many proposals for dealing with the situation.

Surplus farm commodities, under the law, generally cannot be sold in domestic markets for less than 5 per cent above their current support prices plus reasonable carrying charges. Exceptions are made for stocks in danger of deterioration, or for an emergency pinch in supplies due to a short crop or other causes. Thus, with current production of most products more than ample for immediate needs, there is little opportunity for domestic sales of surpluses.

Moreover, domestic cut-rate sales, even when sanctioned, can create additional problems. Thus when the CCC in May started selling its stocks of nonfat dried milk for use in animal and poultry feeds, processors of whey products and dried buttermilk protested that their loss of markets would have an adverse effect on their prices paid to producers of milk and butterfat.

On the dairy production side, Secretary Benson, in accordance with current permissive legislation, cut price supports on dairy products from 90 to 75 per cent of parity effective last April 1; but with corn, the chief feed crop, still supported at 90 per cent of parity, the dairy interests have fought this action and in the House succeeded in having included in the farm bill a provision for mandatory supports at 80 per cent of parity for those products in the period September 1 to March 31 next.

Opposition to the much-talked-about program for domestic disposal of butter at cut prices came not only from producers of competing products, particularly margarine and edible vegetable oils, but also from butter producers themselves who feared the effect on sales of current output. As estimated costs of administration were found to be excessively high, the butter program was discarded before it was tried.

The Secretary even considered a direct payment plan for dairy products whereby prices would fall to market levels, with the Government paying producers the difference between support prices and market prices. The chief advantage cited for this scheme, closely akin to the Brannan plan rejected by the Congress a few years

ago, is that it might halt the accumulation of surpluses in government hands by making it possible for consumers to buy butter and other dairy products at lower prices.

From the standpoint of producers, there would be little difference between a direct payment and the present price support program, other than that the former would bring the subsidies into the open. Both schemes can lead to difficulties. In either case, producers of a commodity are influenced by the net return from the high support price or from the market price plus direct payment. When the return is kept too high, desirable cuts in output of surplus commodities are not forthcoming.

Difficulties in Promoting Exports

Export sales of CCC-owned farm commodities are permitted at below support prices. Selling prices under the International Wheat Agreement are substantially below both the market and support prices for wheat. As a result, IWA wheat exports, whether from CCC or private stocks, are subsidized by the U.S. Government. Although the U.S. export quota under the IWA for the year ended July 31 was 194 million bushels, actual sales were only 106 million bushels. In addition, the U.S. Government, on a basis similar to the IWA, sells CCC-owned wheat to importing nations outside the IWA or to member importing nations whose quotas are filled.

In order to make wheat more attractive to foreign nations, the U.S. several weeks ago lowered its export price by 10 cents a bushel, in effect increasing the subsidy by that amount. This advantage in the world market was short-lived, for Canada soon matched the price cut. Other commodities also are being offered to foreign nations at cut prices. While some sizable sales have been put through, no noticeable dent has yet been made in the CCC larder.

Nor are export sales at bargain prices without criticism, both here and abroad. Domestic consumers complain that foreign buyers are being subsidized by our taxpayers and can secure commodities, such as butter, at prices cheaper than available to the American public. On the other hand, competing exporting nations charge us with unfair competition and point to our gift of wheat to Pakistan last year as a horrendous example of world dumping. Rival dairy-producing nations have protested vigorously against our recent offers of butter, cheese, and dried milk at world market prices, which incidentally have resulted in only a few sales.

The Administration's Farm Program

Even if the Government should be able to dispose of present holdings of farm products, this affords no lasting solution so long as high support prices without adequate controls on production and marketing result in new surpluses piling up in government hands. Aware of this problem, President Eisenhower, in his farm message to Congress last January, recommended three major lines of action.

First, he called for the replacement beginning January 1, 1955 of the present 90 per cent of parity supports with flexible supports ranging from 75 to 90 per cent of parity on all basic crops, except tobacco. The latter crop, production and marketing of which is restricted, would continue to be supported at 90 per cent of parity.

This approach is not new, since the 1948 and 1949 Agricultural Acts provided a flexible support system, the operation of which the Congress has always managed to defer until some future date which, like tomorrow, never arrives.

Second, the President recommended that the modernized parity formula be used to determine the level of price support for corn, cotton, wheat, and peanuts, effective January 1, 1956. These four crops are the only ones still having the advantage of old parity, calculated on the basis of horse-farming during the pre-World War I period of 1909-14.

Third, the President asked for authority to set aside and insulate from commercial markets $2.5 billion worth of surplus farm commodities now held by the CCC. These commodities, when set-aside, would not be counted in the total of supplies used in calculating price supports under the flexible system. Under present legislation all supplies of a particular commodity are included in the formula for determining rates of price support. These frozen reserves, which would be rotated to prevent deterioration, would be designated for (1) use in school lunch programs, (2) disaster relief, (3) aid to foreign nations, and (4) stockpiles accumulated for use in war or other emergency.

The Administration has also sent trade missions to Europe, Asia, and Latin America to look into the possibility of new outlets for farm products. Only time can tell if their efforts are to be successful. In this connection, the President on July 10 signed a bill which over the next three years provides $700 million to negotiate agreements with friendly countries for the sale of surplus farm commodities for foreign currencies, and in addition provides $300 million for con-

tinuation of famine relief abroad. This program, if it works, may kill two birds with one stone; in addition to working down our farm surpluses, it should implement U.S. foreign policy and strengthen our frontiers of world defense.

Enactment of the Administration's program of flexible supports, including provision for the $2.5 billion surplus commodity set-aside, would for 1955 crops result in the support on wheat alone being substantially below the '54 rates. However, even the indicated wheat support would be close to 80 per cent of parity and not the minimum 75. As a matter of fact, both the President and Secretary Benson have indicated that price support on 1955 wheat would not be set at less than 80 per cent of parity regardless of the kind of farm bill the Congress approves, or even if no new legislation is enacted.

Crop Controls Tightened

Disposal of our large surpluses such as in wheat and cotton obviously cannot be accomplished overnight. Recently, the grain trade estimated that it would take three to four years to dispose of our excess wheat stocks abroad, provided both rigid acreage and "bushel controls" were in effect. The latter would limit marketings to a specified number of bushels, thereby discouraging farmers from offsetting acreage limitations by increased production per acre.

While the Congress has been wrangling over farm legislation, Secretary Benson has gone ahead with institution of tighter crop controls. On June 21 he invoked the minimum national wheat allotment of 55 million acres and proclaimed marketing quotas on the 1955 crop, the latter being approved by producers voting in a referendum held July 23. Each grower of wheat and other crops will be required to comply with acreage allotments on all crops in order to secure price support on any crop produced on his farm that year. Such multiple-compliance will prevent producers from securing support on one crop while overplanting allotments for other restricted crops, as has been done in the past.

In addition, the Secretary announced that an overall acreage allotment will be established for each farm in cases where allotments call for diversion in 1955 of more than 10 acres from the production of allotment crops. Producers must keep within the total acreage allotment in order to be eligible for price support on any crop. The lack of a similar requirement this year has been largely responsible for the greater acreage of various feed grains, soybeans, flaxseed, and other cash crops.

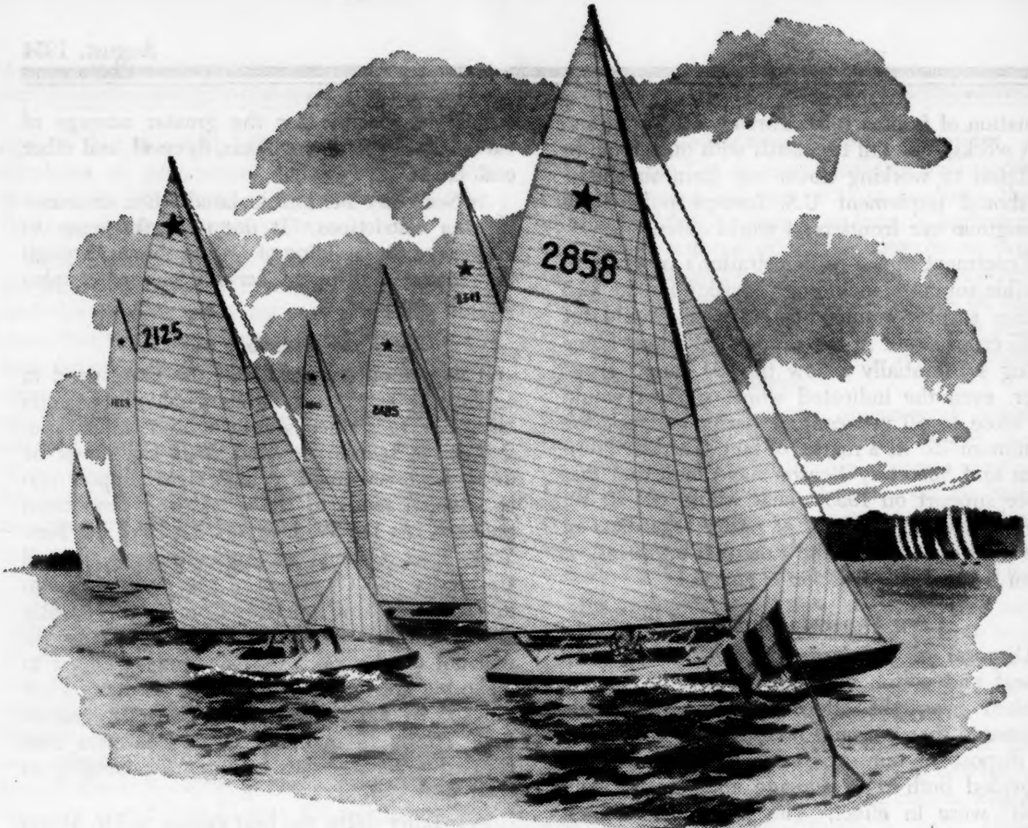
As Secretary Benson declared when announcing the restrictions, "It doesn't make sense to encourage the building of new problems through the unwise shifting of acres from one surplus crop to another."

Case for Flexible Supports

It is generally agreed that the basic need in agriculture is to help farmers make the shifts necessary to reduce surpluses and adjust production to market demand. This can never be done, however, under a high rigid support system which tends to freeze existing production patterns. As Dr. W. I. Myers, Dean of the New York State College of Agriculture at Cornell University and Chairman of the President's National Agricultural Advisory Committee, recently stated, "High supports, even with rigid controls, will not do the job. . . . Government efforts to make big and quick cuts in farm production are blocked by agriculture's need for self-preservation. Trying to maintain output, farmers beat restrictive acreage cuts by intensive farming on their best land."

In making shifts, the best guides, as Dr. Myers pointed out, are relative prices of alternative products – which means lower prices for products in surplus. This, surely, is the only scheme that makes sense. Not only would lower supports for products in surplus encourage desirable shifts, both on the production and consumption side, but – equally important – they would give incentive for keeping marginal land out of cultivation, culling low producing poultry and livestock, and promoting more efficient farming generally.

Looking to the future, there will probably be over 200 million Americans by 1975, and American agriculture will have a big task in providing the food and fiber required by this rapidly growing population. This food and industrial raw material, however, must be of the kind that will be consumed and not produced merely to accumulate in government storage bins. To quote Dr. Myers again, "The best way of using excess agricultural production is to eat more meat, milk, eggs, and livestock products." But unless our farm policies are realistic and flexible, encouraging output of the products the people really want, the Government will find itself getting involved more and more deeply despite the vast potential home market.



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